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FOREWORD

Following discussions with representatives of the Canadian business community, the Prices and Incomes Commission called a National Conference on Price Stability to obtain a consensus on a program of price restraint. Those present at the conference, held in Ottawa on Feb. 9-10, indicated that, in their view, Canadian business firms would be willing to exercise a meaningful degree of restraint in their pricing policies in 1970. There was broad agreement that business firms generally, if called upon to do so, would reduce the number and size of price increases they would normally make in 1970 and would ensure that price increases were clearly less than the amount needed to cover increases in costs.

It was agreed that the Commission would keep export industries under review and when developments in one of these industries impaired the general price restraint program, appropriate solutions would be sought.

At a Federal-Provincial Conference of First Ministers, held in Ottawa on Feb. 16-17, 1970, the Heads of Government endorsed the Commission's plan. Governments expressed the hope that sanctions would not be required but agreed that if necessary they would use such means as are within their control to deal with cases of serious non-compliance with the pricing criteria.

AUTOMOBILE PRICES

Introduction

The Prices and Incomes Commission was in touch with the larger motor car manufacturers in July and August of 1970 concerning possible changes in prices for 1971 models. Although none of the vehicle manufacturers had announced price changes for the forthcoming 1971 models at that time, they indicated that consideration was being given to price increases. As a result, the Commission stated publicly on Aug. 7, 1970, that it would review any price increases for 1971 models as soon as they were available in order to determine whether they met the pricing criteria.

In the fall of 1970 the major producers of automobiles announced increases in their prices. The companies stated that these price increases were tentative and were subject to change after the completion of their negotiations with the United Auto Workers.

General Motors of Canada Ltd. announced tentative increases in list prices which on average were 1.6 per cent higher than prices of comparably-equipped 1970 models. Increases averaging 5.1 per cent were made for optional equipment. It is estimated that the total price increase of cars and equipment would average about 2.1 per cent higher than in 1970.

The Ford Motor Co. of Canada announced price increases of three per cent for all but four of its 1971 models. Prices of four sports car models were reduced by an average of 1.8 per cent from 1970 price levels. The prices of optional equipment were increased on average by three per cent. In November, Ford announced additional price increases of about 0.4 per cent.

Chrysler Canada Ltd. announced a number of price changes in October. The over-all increase in prices is estimated to be about 2.3 per cent higher on average for 1971 models than for 1970 models with comparable equipment. While prices were increased for most models of compact cars, the prices for new full-sized Chrysler, Dodge and Plymouth cars were reduced by an average of 0.5 per cent.

Automobile Producers

General Motors, Ford and Chrysler together assemble approximately 95 per cent of the total number of automobiles made in Canada. As a result, the Commission has concentrated its study on their operations.

Other well-known companies also produce automobiles in Canada. American Motors (Canada) Ltd. assemble cars at its plant in Brampton, Ont.; Volvo (Canada) Ltd. and Canadian Motor Industries (Toyota) assemble cars in Nova Scotia; and Soma Inc. (Société de Montage Automobile Inc.) assemble Renault passenger cars in Quebec. Because the production of these firms is much smaller than that of the "Big Three" a detailed review has not been made of their prices.

Canada-United States Automotive Agreement

The Canada-United States Automotive Agreement has had a very considerable influence on Canadian auto prices and has affected the operations of every passenger-car producer in Canada.

When the agreement was implemented in 1965, the Minister of Industry made the following statement:

"Of significance for the Canadian consumer is the fact that over several years the plan should progressively make possible increased efficiency and reduced costs. Indeed, this is one of the principal objectives of the entire program. In line with the attainment of lower costs of production, it is to be anticipated, as the program develops, that the forces of competition will gradually result in savings for Canadian consumers in the form of a narrowing differential between Canadian and United States prices for motor vehicles and components."

Prior to the implementation of this agreement, the prices of automobiles were considerably higher in Canada than in the United States. To a large extent the price differentials reflected the higher costs of production and distribution in Canada. Like a number of other Canadian industries, the auto industry found its markets primarily in Canada and in certain parts of the Commonwealth which extend preferential tariff treatment to Canadian automotive products. The limited size of these markets and the resultant short-production runs meant higher costs than those experienced by producers in

other countries who were able to realize the economies of volume production and greater specialization.

In recent years the proliferation of models and styles and the associated high costs of tooling and production intensified the problems of short-production runs. As a result, costs mounted more rapidly in Canada than in the United States or in other countries which were able to realize the benefits of specialization and rationalization.

As the domestic industry's competitive position worsened, imports of vehicles from overseas sources increased and Canada's relatively small export trade in automobiles was further impaired.

The Minister of Industry indicated in 1965 that, for the first time, the auto agreement gave both vehicle assemblers and parts makers duty-free access to North American markets. For the first time, producers in Canada and the United States were placed in a position to rationalize their output and to realize the economies of specialization on a much broader basis than previously was the case.

Obviously a transition of this magnitude in one of Canada's largest industries could not be completed in a short period of time. It required the investment of hundreds of millions of dollars, the training and retraining of thousands of workers and the adoption of new production, distribution and marketing practices. After almost five years the process is still under way and is not likely to be completed for some time.

Production, components, procurement and exports and imports in the industry have changed greatly during the past five years. Canadian auto plants have specialized in the assembly of relatively few models. A large part of this output now is shipped to markets in the United States. Canadian parts makers have also become much more specialized and now find a large part of their market in the United States. On the other hand, a substantial portion of the Canadian market for automobiles now is supplied from factories in the United States. Parts manufacturers in that country continue to supply a substantial portion of the requirements of the Canadian market, both for assembly and replacement purposes. Thus a greatly expanded two-way trade has

developed in automotive production and the over-all efficiency of the industry has been improved.

Markets

Despite the improved position of the Canadian automotive industry in terms of specialization, efficiency and access to the North American industry, it faces a number of serious problems. Its costs have continued to rise, prices of materials, including steel (the largest single-component material) continue to increase and the forthcoming labor settlements will involve substantial increases in wage rates and fringe benefits.

The resulting cost squeeze has come at a time when demand for North American-type vehicles has fallen well below previous levels and competition from foreign car producers has been intensifying.

The volume of imported vehicles (other than from the United States) has increased sharply in recent years. Japan has emerged as a major supplier of vehicles and Britain and Germany have shown new vigor in selling automobiles in the Canadian market.

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Imports into Canada of Motor Vehicles

(Values in Millions of Dollars)

	Japan		Britain		W. Germany		Other (Excl. U.S.)	
	No.	$	No.	$	No.	$	No.	$
1966	2,858	3.9	30,604	43.0	28,365	33.9	13,532	17.4
1967	6,185	7.0	24,738	38.9	29,411	36.4	16,907	22.7
1968	24,970	25.3	44,571	60.1	43,460	57.4	24,482	34.0
1969	55,285	61.1	50,192	76.1	43,433	64.6	29,727	42.2

The impact of these imported vehicles is clearly illustrated by the following table of registrations of new cars (imports have risen from 10 per cent to more than 20 per cent of total registrations):

Registrations of Passenger Cars in Canada

	North American Types		Off-Shore Types	
1966	612,900	(89.7)*	70,739	(10.3)*
1967	594,827	(89.1)*	72,987	(10.9)*
1968	636,510	(86.3)*	101,095	(13.7)*
1969	631,528	(83.5)*	124,487	(16.5)*
1970 (8 months)	339,042	(79.2)*	89,085	(20.8)*

*Percentage of Total

The bulk of the motor vehicles imported from overseas are small or compact cars. This type of vehicle, with its low initial cost and economy of operation, is being sold to increasing numbers of consumers. This is not the first time that such a trend has developed. In 1960, approximately 180,000 vehicles were imported, mostly of smaller sizes from overseas suppliers. These automobiles represented 33 per cent of motor vehicles sold in that year.

The North American auto industry introduced the "compact car" to compete with the smaller imported vehicles during the early 1960s. It is said that because these vehicles have tended to grow in size over the years they no longer compete with the imported small cars. In order to meet competition from the small vehicles imported from overseas, the North American car producers now have introduced several models of sub-compact cars, some of which are assembled in Canada.

Approach Used in Undertaking Review

The implementation of the automotive agreement, the trend to greater specialization, the development of a substantial two-way trade between affiliated companies in North America and the increase in the volume of imported

vehicles from off shore raise a wide range of issues. The purpose of this price review is, however, to examine a much narrower aspect of the operations of the industry. Its objective is to determine whether the price increases brought into effect by the Canadian auto producers meet the pricing criteria agreed to at the National Conference on Price Stability.

In essence, the criteria state that any increment to revenues in 1970 resulting from price increases in that year must be clearly less than the increments to costs in 1970. The criteria are applied on an individual company basis so that it was necessary to obtain and measure costs and revenues and other pertinent data for each firm being reviewed.

In addition, the criteria state that 1969 will in general be used as the base year when considering changes in costs and revenues. In cases where 1969 is clearly inappropriate, a suitable alternative base period may be selected.

The criteria also provide that, in making reviews, it is necessary to consider costs and revenues at normal sales volume. In other words, the distortions resulting from disruptions to normal volumes of output should be eliminated from the calculations of costs and revenues.

Detailed financial and other information has been obtained from General Motors, Ford and Chrysler on their Canadian operations. This information relates to the manufacture and sale of motor vehicles and auto parts but excludes the operations of these firms in other fields, i.e. appliances, tractors, construction equipment, etc.

Many of the transactions of all three firms, both in buying and selling, are not at arms-length. Each company was asked, therefore, to indicate the basis for such transactions and any changes which were introduced during the period under study that would affect either costs or revenues. In other words, the Commission wished to ensure that each company's results would not be distorted by changes in methods of valuing transactions with related companies. In the case of one company certain procedures had, in fact, been changed so that it was necessary to make appropriate revisions in its data. This was done by valuing all transactions according to the method used at the beginning of the period under review. This adjustment diminished the differential between revenues and costs.

In two cases, Ford and Chrysler, production and sales for the first 10 months of 1970, plus a projection for the balance of the year, were accepted as normal volume for 1970.

On Sept. 15, 1970, General Motors' plants were closed by a strike resulting from a deadlock in the negotiations for the renewal of its three-year contract with the United Auto Workers. At the time of writing this strike had not yet been finally settled and production had not resumed. In view of this situation, the Commission obtained actual financial results for eight months and an estimate of operations for the remaining four months at the levels of production and sales which probably would have prevailed if there had not been a strike.

Because 1969 appeared to be a year of normal operations for General Motors and Ford, it was used as the base. In the case of Chrysler, however, neither 1968 nor 1969 appeared to be normal years, the former year being one of high levels of profitability and the latter year being one when profits were well below the

average of recent years. As a result, it was decided that an average of the period 1966-69 would be a more representative base.

In all cases the companies being reviewed keep their financial records on a calendar-year basis.

Costs

Materials are the largest single element of cost in the manufacture of automobiles. In a typical full-sized vehicle there are 1.7 tons of iron and steel, 33 pounds of copper, 64 pounds of aluminum, 23 pounds of lead and 44 pounds of zinc.

Steel prices were approximately five per cent higher in 1970 than in 1969 and further price increases were announced in November, 1970. Although prices of primary aluminum have not increased in Canada in 1970, the prices of aluminum products have risen by an estimated five per cent. Copper prices were considerably higher in 1970 than during 1969. Lead and zinc prices declined but the price of nickel, which is an ingredient of stainless steel, was higher in 1970 than 1969.

Freight is an important element of cost of materials, components and vehicles. Rail freight and truck rates have increased by significant amounts in 1970 and are reflected in higher costs and prices.

Municipal taxes are a significant item of cost and on the whole have increased in 1970. Fuel and energy costs have risen considerably during the year and the industry is a substantial user of both.

Direct wages, salaries and fringe benefits are important items of cost and will be increased as a result of the negotiations currently under way between the companies and the UAW. While agreement between General Motors and the union appeared imminent at the time this report was written, negotiations had not yet been concluded between Ford and Chrysler and the UAW. There is also considerable labor content in the great variety of components which the industry purchases for assembly.

In arriving at cost figures for 1970 for purposes of this review, the companies allowed for some increase in wages, salaries and fringe benefits. On the basis of information available to date on the likely outcome of the negotiations it would appear that the increments used will be well below the final settlement figures. To this extent, the cost increments for 1970 are probably understated.

Each of the three companies supplied detailed breakdowns of their costs to the Commission.

Revenues

Sales of North American-made automobiles have fallen sharply in Canada in 1970, as the table on page 10 indicates. The same trend is true in the United States where sales of North American vehicles are one million vehicles below 1969. On the other hand, sales in both countries of vehicles imported from overseas have increased appreciably.

These developments have reduced revenues for the industry. This situation results from two main factors. First, fewer cars have been sold in Canada. Second, the smaller autos, which form a large proportion of sales in 1970, bear lower margins of profit than the larger cars.

Production volume of Ford and Chrysler has held up relatively well in 1970 because these two companies have concentrated on the manufacture of small- and medium-sized cars in Canada. General Motors has placed more emphasis on the production of large cars in Canada.

Because of these developments, revenues in 1970 will be substantially lower than in 1969. Even when the loss of revenue for General Motors resulting from the strike is eliminated from the calculations (and revenues are estimated as if General Motors had realized a full production year), the resulting level of revenue for 1970 is well below 1969.

CONCLUSION

The trends in costs and revenues for the automobile industry in Canada have been moving in opposite directions; costs have shown a considerable upward movement while revenues have declined.

Cost increases for General Motors and Ford in 1970 compared with 1969, which is a normal base year for both companies, are clearly more than increases in revenues over the same period.

In the case of Chrysler, neither 1968 nor 1969 were normal years, the former being a year of relatively high profitability and the latter being one when profits were well below the average of recent years. Thus, in order to establish a representative base period, it was necessary to take an average for the period 1966-69. Cost increases for Chrysler in 1970 compared with this base are higher than revenue increases over the same period.

The three major automobile manufacturers in Canada have thus met the criteria agreed to in February, 1970.

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